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DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

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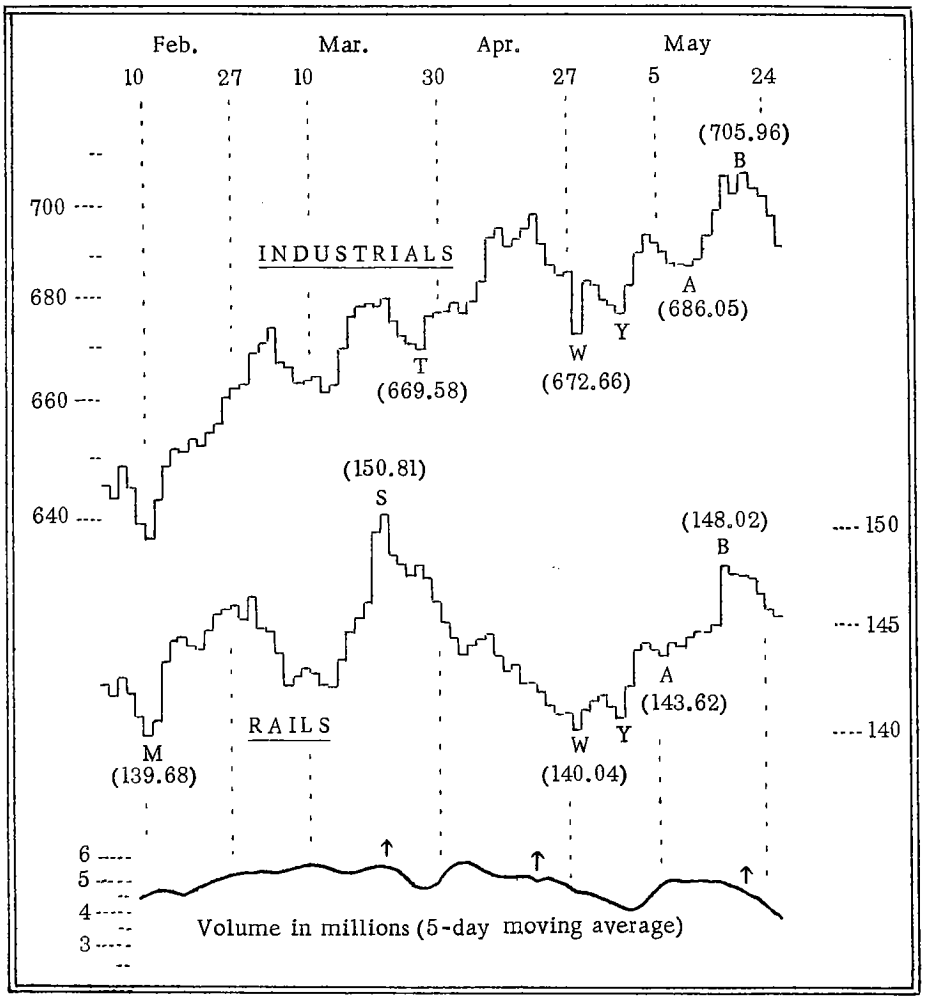
THE MARKET It is remarkable to observe how, in a little more than two weeks, the character of the market has changed. First, activity switched from the "glamour group" to the "big stocks", then volume receded, and a general soberness seemed to blanket Wall Street. Finally, the big stocks stumbled.

Whether all this is a result of the Supreme Court decision, the investigations and warnings by the S.E.C., or whether it represents something more fundamental than either of these cannot be known at this time. Perhaps a few investors are even nervous about "The New Frontier" and its efforts to reinflate the balloon. If consumers have enough homes (and the 14% drop in contracts for homes in April suggests that they may), if apartment houses are being built as vacancies rise, if retail sales appear sluggish and if tool orders falter, if the "Fed" has trouble "holding up" the bond market, we can simply raise taxes, turn to more deficit spending, remove the 25% gold clause, and let "Big Daddy" handle the pump. Perhaps a few timid souls entertain doubts as to whether one can continually take pennies from Junior's piggie bank to keep the family prosperous, but it is fruitless to worry about such trivia.



Based on volume and the price movements, a speculative "buy-spot" was identified at the Y points in the 672-6 level on the Industrial Average (Letter 142). Because the Y points were very close to T on Industrials and M on Rails, I felt that stocks could be purchased in the 672-6 area with the stipulation that they be sold if a subsequent reversal resulted in the T and M levels being violated.

In other words, the T and M points represented the levels which, if violated, would represent a reversal of the secondary trend. Following Letter 142 the market rallied sharply, and new (higher) decline points were established at the

A levels (see chart -- page 1). Because new "insurance" levels were registered in the price structure Letter 144 stated: "If one or both Averages can hold above the preceding A points (Indust. 686.05, Rails 143.62) as volume contracts, the secondary trend will remain bullish. Conversely, if the A points are jointly broken on heavy volume there is a good chance that the secondary trend will have turned down."

The chart of the Averages includes one temporary change this week. I have arranged volume in the form of a five-day moving average. In this way sharp volume fluctuations are smoothed out, and the trend of volume can be more easily spotted. What we see on the moving average of volume is a little disturbing. The three arrows on the chart identify the three most recent peaks in the Averages. Note that the tendency of volume has been to recede as the market rises to successive peaks. Although this diminishing volume cannot pinpoint the end of a move, it is a phenomenon which has, in the past, served as a warning. Declining volume on rallies often coincided with a turn down in breadth. Volume from now on will bear close watching with the stipulation that advances on dull or declining volume should be viewed with increasing suspicion.

Industrials have recorded a new all-time high unconfirmed (so far) by Rails. According to the "continuing trend" principle, the secondary (and primary) trends remain bullish. However, prior to new highs, if both Averages turn down and violate the A points on heavy volume, I would take this action as bearish enough to justify selling stocks which were purchased at recent levels. Should further weakness result in the W points being violated, I would hold few if any stocks.

A FASCINATING HISTORY The tabulation of daily odd-lot transactions did not begin until 1936. In 1939, however, the Brookings Institute completed a study of monthly odd-lot transactions going back to 1920. The Brookings tabulations were taken directly from dealers' books and must be considered accurate. With the kind permission of Mr. Garfield Drew I am including a chart showing all monthly odd-lot transactions from 1920 to the present superimposed upon the movements of the D-J Industrial Average (these figures are from a special chart book published by Drew Investment Associates in Boston). In order that trends can be seen to better advantage, the monthly odd-lot figures are plotted in the form of a three-month moving-average.

There are a few odd-lot characteristics which should be understood by anyone who is interested in market psychology. (1) The odd-lot public is normally optimistic, and they normally buy more shares than they sell. Perhaps 10 shares bought for every 9 sold (a ratio of 90 on the chart) could be termed "normal".

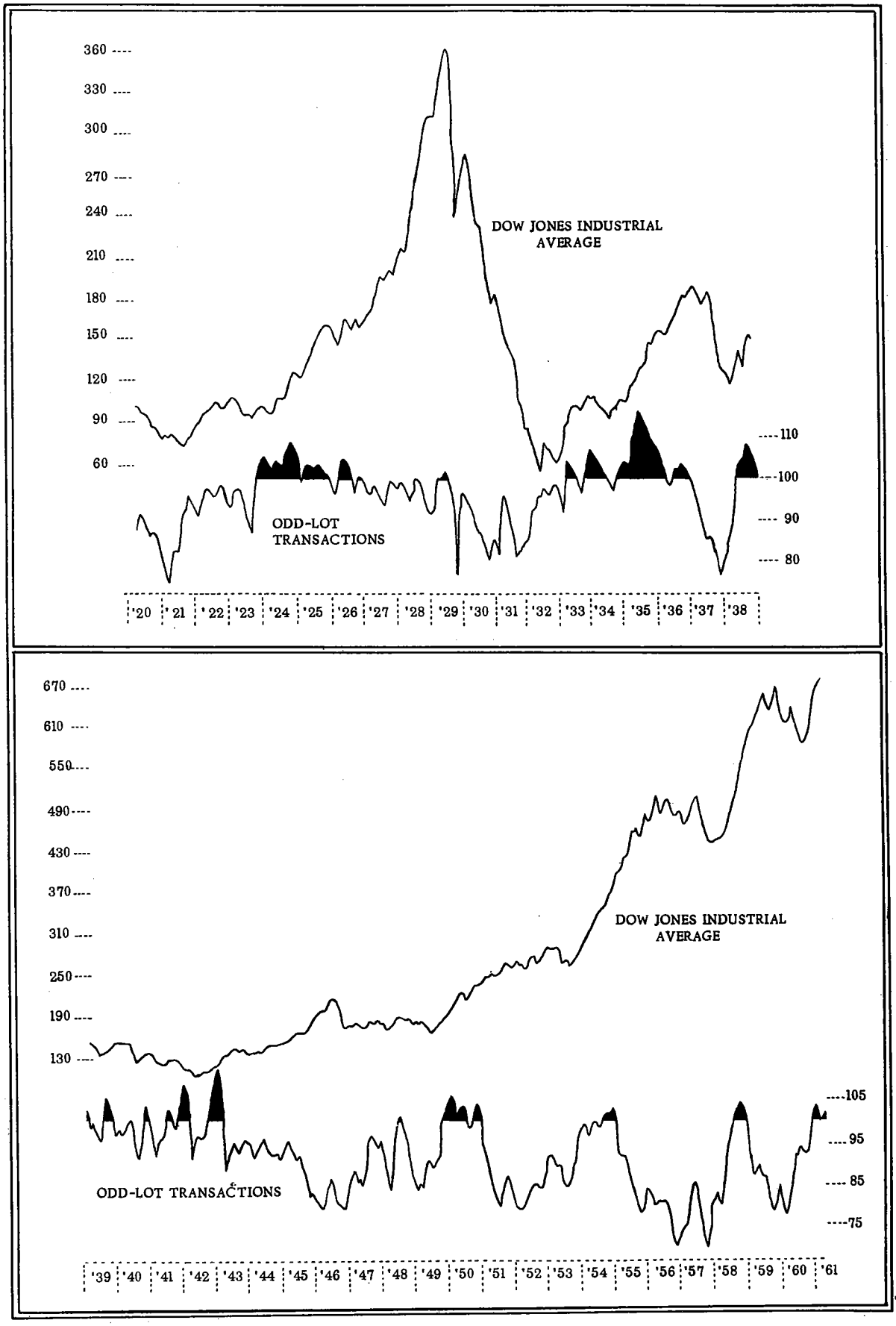
(2) Any abnormal behavior in odd-lot sentiment is usually significant. Periods in which odd-lotters sell more than they buy (ratio over 100) are considered abnormal (the solid black areas on the chart show regions of odd-lot selling, and these periods are few and far between.)

(3) There is a normal tendency by odd-lotters to increase buying as a decline progresses ("lower prices are bargains"). Therefore, if, on a decline, odd-lot transactions switch from buying to selling or from heavy buying to lighter buying -- the situation is abnormal. Pessimism as evinced by odd-lot transactions during a decline often coincides with the end of a decline.

(4) Normally, odd-lotters decrease buying during an advance ("higher prices provide selling opportunities"). If, during an advance, odd-lot buying increases steadily or odd-lot selling tends towards buying, this switch in sentiment is abnormal. Such a change in sentiment represents a deteriorating situation and often signals an approaching top.

(5) The changes in sentiment are most significant in odd-lot transactions, and these changes are far more important than the actual level of buying or selling. A switch from light selling to heavy selling can be as significant as a switch, for instance, from light buying to light selling.

Note that since 1920 there were about 12 broad areas in which the abnormal situation of more odd-lot selling than buying occurred. In the great majority of cases, each of these areas were followed by higher prices. Taking the period from 1949 to the present, there have been four areas of odd-lot selling sufficient to show up on the monthly chart.


360
330
300
270
240
210
180
150
120
90
60
DOW JONES INDUSTRIAL AVERAGE
ODD-LOT TRANSACTIONS
110
100
90
80
'20 '21 '22 '23 '24 '25 '26 '27 '28 '29 '30 '31 '32 '33 '34 '35 '36 '37 '38
670
610
550
490
430
370
310
250
190
130
DOW JONES INDUSTRIAL AVERAGE
ODD-LOT TRANSACTIONS
105
95
85
75
'39 '40 '41 '42 '43 '44 '45 '46 '47 '48 '49 '50 '51 '52 '53 '54 '55 '56 '57 '58 '59 '60 '61

A warning: a great deal has been said and written by financial analysts concerning the recent extended area of odd-lot selling. It should again be stressed that the changes in odd-lot sentiment are more important than the levels of buying or selling. Although odd-lot transactions have remained steadily on the selling side during the past six months, the last three months show little change in the actual level. For this reason the next change in sentiment, whether it be to more selling, less selling or to actual buying, should be most significant.

STOCKS Following up our continuing discussion of the fifteen Dow stocks: General Motors made the headlines with the unfavorable supreme court decision. The weekly chart shows G.M. moving down to exactly its 30-week moving average (M.A.) which now stands at 43 7/8. Support has been coming in at the 44 area, which suggests that all is not yet lost. Should G.M. refuse to show rallying tendencies from the 44 level and then drop below 42 a good case could be made for its having "topped out".

DuPont by last week had rallied 28 points above its M.A. which is now 201. Whether the news or its technical position was responsible for the drop we cannot know, but in the vast majority of cases when a stock advances too far from its M.A. it is overdue for a correction. The accompanying chart (courtesy of Traders Research, 6185 Lambert Airport, Mo.) shows the importance of the 200 level (dotted line) for DD.

International Paper (see Letter 143) rose above its M.A. a few weeks ago, touched a high for the year, then sank back to its M.A. which is now 32 3/4. The stock is still in an uptrend.

Standard Oil of New Jersey has been drifting quietly lower since mid-April. The M.A. is now 43 3/4. As is the case with most of the Dow stocks, nothing has happened yet to suggest that the stock is not in an uptrend.

Southern Pacific tends to move with the Rail Average (see Letter 137). It broke out of its "line" formation at 23 1/2 at which point it was recommended. SX has held above its M.A. since December, 1960, and the M.A. has now risen to 21 7/8. A decline to 21 would be a "sell signal".

(Written - Monday, May 29th - 10 A.M.)